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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 439

HERLONG SIERRA HOMES, INC., *Petitioner,*

v.

THE UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Ninth Circuit, dated and entered March 24, 1966.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix A) is reported at 358 F.2d 300. The opinion of the District Court (Appendix B) is unreported.

JURISDICTION

The opinion and judgment of the Court of Appeals were entered on March 24, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Does federal or state law govern the dealings of private parties, the assignee of one such private party being the United States, in the seeking of a deficiency judgment after foreclosure of a mortgage loan?

2. Does a builder of a Wherry military housing project assume the risk, as the District Court found, that the Army will prevent or hinder performance of the contract?

STATUTORY PROVISIONS INVOLVED

12 U.S.C. § 1748b(a) provides:

> "(a) In order to assist in relieving the acute shortage and urgent need for family housing which now exists at or in areas adjacent to military installations because of uncertainty as to the permanency of such installations and to increase the supply of necessary family housing accommodations for personnel at such installations, the Commissioner is authorized, upon application of the mortgagee, to insure mortgages (including advances on such mortgages during construction) which are eligible for insurance as hereinafter provided, and, upon such terms as the Commissioner may prescribe, to make commitments for so insuring such mortgages prior to the date of their execution or disbursement thereon: *Provided,* That the aggregate amount of principal obligations of all mortgages insured under this subchapter (except mortgages insured pursuant to the provisions of this subchapter in effect prior

to August 11, 1955) shall not exceed $2,300,000,000: *And provided further,* That the limitation in section 1715h of this title shall not apply to this subchapter: *And provided further,* That no mortgage shall be insured under this subchapter after June 30, 1958, except pursuant to a commitment to insure issued before such date."

28 U.S.C. § 1254(1) provides:

"Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

"(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;"

28 U.S.C. § 1345 provides:

"Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress."

Section 580(b), California Code of Civil Procedure, provides:

"No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property.

"Where both a chattel mortgage or deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof."

STATEMENT OF THE CASE

The United States brought this action, under Title 28 U.S.C. § 1345, to foreclose a deed of trust held by the Federal Housing Authority (hereinafter referred to as FHA). The deed of trust secures a note in the amount of $1,113,700.00 given by Petitioner. The amount represents a loan acquired by Petitioner for the purpose of financing the construction of a rental housing project for military and civilian personnel at Sierra Ordnance Depot, a federal enclave located in an isolated area of Lassen County, California.

Negotiations leading to the financing of Petitioner's project were made pursuant to the authority of the National Housing Act of 1934 (Title 12 U.S.C. § 1702), and of the Act of August 8, 1949, known as the "Wherry Act" (Title 12 U.S.C. § 1748 *et seq.*). Because of a housing shortage existing at the Depot, its Commanding Officer requested the construction of some 456 dwelling units to house civilian and military personnel employed at the Depot, and the request was approved by the Headquarters of the Sixth Army and by FHA. Negotiations were carried on among the Department of Defense, FHA, and Housing and Home Finance Agency (HHFA, also a Federal agency) to obtain the construction of these units. The negotiations resulted in the issuance by the Defense Department, on October 24, 1951, of a certification to FHA that 125 units were necessary to provide adequate rental housing for Depot personnel; that the Depot was deemed a permanent installation; and that there was no present intention to substantially curtail activities at the Depot. Petitioner filed application, received approval, and undertook the construction of these units.

In order for the units constructed by petitioners to have met their costs, it had been determined that 92% occupancy would be required. Recognizing his responsibility under Army Regulations, the Commanding General of the Sixth Army adopted a policy designed to encourage the maximum occupancy of the units; in implementation of such policy, Commanding General, Sixth Army, directed his subordinate, Commanding Officer of the Depot, to take certain specified action to insure the requisite occupancy.

On March 3, 1955, Petitioner executed and delivered to the Manufacturers Trust Company its note, secured by a deed of trust on lands leased to Petitioner by the United States upon which the housing units were to be constructed together with the housing units thereafter constructed on the property. Repayment of the loan was insured by FHA, which is now the holder of the note and the deed of trust by assignment. Petitioner defaulted in payments due under the note, because actions of the Depot Commander precluded occupancy of the rental units despite the fact that all concerned knew that tenants could come only from the Depot and the project was built solely because existing Depot housing was found substandard by the Army. The United States instituted this action to foreclose the deed of trust. The District Court held (Conclusions of Law Nos. 1, 2 and 3): (a) plaintiff was entitled to foreclosure of the property; (b) federal law, and not California law, determines whether plaintiff would be entitled to a deficiency judgment if foreclosure sale should result in a deficiency; (c) applying federal law, plaintiff is entitled to a deficiency if proceeds from sale are insufficient to pay the amount due. The Court of Appeals affirmed. The

government purchased at the foreclosure sale for $500,000, and the deficiency found due the FHA insurance fund was in excess of $700,000.

ARGUMENT

The promissory note made by Petitioner and given to Manufacturers Trust Company as evidence of its indebtedness to repay a loan of $1,113,700 necessary to build the project was, by its explicit terms, to be construed according to the laws of California. FHA, as insurer, approved the terms of the note, as it had the right to do "upon such terms as the Commissioner may prescribe." 12 U.S.C. § 1748b(a). Here, all three parties and their counsel carefully worked out the terms of a loan in excess of a million dollars and all agreed that California law should apply in all respects, but the Courts below have determined that California law should not be applied. In so doing, several cases from federal courts were cited, but not the most recent applicable opinion of this Court. The most pertinent holding of this Court is *U.S.* v. *Yazell,* 382 U.S. 341, 15 L.Ed 2d 404, 86 S. Ct. 500 (1966). There this Court held that state law should apply where: (1) the note was negotiated with particular reference to state law: (2) it was a "custom-made, hand-tailored, specifically negotiated transaction"; (3) there is no need for uniformity in the circumstances; (4) there is absent any "federal statute, regulation or even any contract provision indicating that state law would be disregarded". All of these factors are here present and state law should likewise be followed. In addition, SBA was the lender in *Yazell,* while here FHA was only the insurer. Obviously there is a more direct federal interest where the government is the direct lender rather than

an insuror. Nor is there "a significant conflict between some federal policy or interest and the use of state law in the premises", *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 16 L. Ed. 2d 369, 373, 86 S. Ct. 1301 (1966), since there is no federal statute or expression of legislative intent authorizing collection of deficiency judgments, much less pre-empting state law on the subject.

The instant case is also marked by the fact that the party seeking to collect the deficiency judgment is a very sophisticated insurer which has accumulated an insurance premium reserve in excess of $35,000,000 as of June 30, 1964. It insures only when it approves the terms of the loan, including what law shall apply. Title VIII of the National Housing Act set up a statutory scheme to induce private enterprise to assume a partial risk in the construction of low-cost rental housing for the military and civilian personnel of the United States. The United States investment was protected by the real and personal property which secured the debt and the insurance premium fund. Petitioner has already lost all equity in the project and the insurance premiums have been paid. Could there be some compelling federal interest in sticking petitioner further with a deficiency judgment of over $700,000 not based upon any federal statute and contrary to the law of California which the promissory note said would control?

Title VIII of the National Housing Act nowhere mentions any right of FHA to obtain a deficiency judgment under federal or state law. In fact, the legislative history points the other way. In House Report 854, 81st Cong., the Banking and Currency Committee in explaining the purpose of the Wherry Act said:

> "The bill is designed to encourage them [builders] to construct such housing. Where housing is constructed with mortgage insurance under the bill, no cost to the Government would be involved unless, through deactivation or curtailment of military installations or other causes there are losses in excess of the premium and other payments by the mortgagee to the insurance fund.
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> * * * * * *
>
> "As housing is insured under Title VIII, the fund would, of course, be augmented by deposits of fees and insurance premiums authorized to be collected under the bill, and, except in the event of unusual losses the fund should be self-sustaining."

No mention is made of obtaining deficiency judgments to augment the fund, and this is not surprising since some states forbid deficiency judgments. Surely had Congress intended the fund to be augmented by such judgments, it would have clearly spoken out and authorized this as a matter of national and uniform policy. Certainly it cannot be said that Congress has authorized the assignee of the mortgagee (FHA) to override state law where the mortgagee had agreed that the transaction was to be governed by state law. § 580 (b) of the California Code of Civil Procedure (p. 3 herein) clearly prohibits a deficiency judgment under these factual circumstances.

II

The District Court held "Defendant must be deemed to have assumed the risk of the actions taken by Colonel Leavitt and his staff insofar as they may have tended to preclude occupancy of defendant's units." The Court of Appeals approved of the District Court's statement. In a factual nutshell, the situation was:

(1) the Secretary of the Army found that existing housing facilities for personnel at this desolate Depot were inadequate and a danger to health and morale; (2) petitioner agreed to build 125 units under plans, specifications and drawings issued and approved by the Department of the Army and FHA; (3) under the law the units were reserved for Depot personnel under rents established by federal agencies; (4) the Project Analysis showed that 92% occupancy was needed to financially support the project; (5) Sixth Army advised the Depot Commander that an "aggressive program adopted to assure maximum occupancy" be instituted; (6) the Depot Commander replied expressing awareness of the "moral obligation and responsibility of the installation commander in securing maximum occupancy of the Wherry units"; (7) the installation commander then issued orders insuring that the necessary occupancy could not be achieved. Despite these actions petitioner borrowed an additional $375,000 to complete the project and all subcontractors were paid.

Is it the law and the intention of Congress that a builder of a Wherry housing project should assume the risk of the bad faith of subordinate officers? We know that in this case the United States is not liable for the action of such officer under the Tort Claims Act. 320 F.2d 425, cert. den. 376 U.S. 906. But there is nothing in the legislative history of the Wherry Act to support such an assumption of bad faith theory. On the contrary, House Report 854, *supra,* recognized that the builder could be at the mercy of the military:

> "Consequently, in analyzing proposed projects to provide housing for military personnel, the *FHA cannot disregard the special risks involved* by reason of the location and the question as to the permanent nature of the military installations.

> "The bill would amend the National Housing Act by providing for a new title establishing a system of mortgage insurance for rental housing to serve the personnel of military and naval installations on substantially the same basis as is now available under section 608 of Title VI. In view of the *special problems involved and the different risk characteristics* presented by such housing, an entirely new insurance fund is proposed for the operation of this new title." (Emphasis supplied.)

Is not the "entirely new insurance fund" with its unused premium reserves in excess of $35,000,000 the party who should assume the risk of bad faith of a subordinate commander rather than the builder which was powerless to prevent the loss of its investment in the face of such bad faith? With all its awareness of special risks, special problems and different risk characteristics would the Congress have ignored the inclusion of the builder assuming the risk of bad faith had it so intended? On the contrary, the Committee Report said, "The bill is designed to encourage them [builders] to construct such housing". The Courts below have interpreted this to mean that the Wherry housing builder must retroactively be deemed to have assumed the risk of governmental bad faith. Such a conclusion cannot be found in the statute, the common law or in common sense.

CONCLUSION

The action of the Court of Appeals in affirming the judgment of the District on the theories that petitioner assumed the risk of governmental bad faith and that federal law and not state law should apply under the circumstances of the case was erroneous. For all

of the foregoing reasons this petition for a writ of certiorari should be granted.

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August 12, 1966

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 19,764

HERLONG-SIERRA HOMES, INC., a corporation, *Appellant*,

v.

UNITED STATES OF AMERICA, *Appellee*.

[March 24, 1966]

Appeal from the United States District Court
for the Northern District of California
Northern Division

Before: HAMLEY, MERRILL, and BROWNING, Circuit Judges

PER CURIAM:

This is an appeal from a judgment in an action by the United States to foreclose a deed of trust and chattel mortgage executed by appellant to secure a loan insured by the Federal Housing Administration under the authority of Title VIII of the National Housing Act, 12 U.S.C.A. § 1748b, in connection with the construction of a rental housing project for military and civilian personnel at the Sierra Ordnance Depot in Lassen County, California. An opinion of this court in related litigation is reported at 320 F.2d 425.

Appellant contends (1) that appellee is precluded from recovery because appellee's wrongful conduct prevented appellant from making the payments due on the note, and (2) that a deficiency judgment was barred by section 580(b) of the California Code of Civil Procedure. These contentions are sufficiently answered by the district court in its memorandum opinion of June 8, 1964. As to the latter, see also *United States* v. *Shiner*, 367 U.S. 374 (1961); *United States* v. *Rossi*, 342 F.2d 505 (9th Cir. 1965).